

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201105003**

Release Date: 2/4/2011

Index Number: 355.01-00, 368.04-00

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:01

PLR-102687-10

Date:

October 25, 2010

Legend:

Distributing =

Controlled =

GP =

LP 1 =

LP 2 =

State A =

Business 1 =

Business 2 =

PLR-102687-10 2

Year 1 =

Year 2 =

Business 1 Employees =
=

=

=

=

Shareholder A =

Shareholder B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

a =

b =

c =

d =

e =

f =
g =
h =
i =
j =
k =
l =

Dear :

This letter responds to your request for rulings on certain federal income tax consequences of the Proposed Transaction described below. The information submitted in that letter and in later correspondence is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction: (i) satisfies the business purpose requirement of § 1.355-2(b) of the Income Tax Regulations; (ii) is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see § 355(a)(1)(B) of the Internal Revenue Code and § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest in Distributing or Controlled (see § 355(e) and § 1.355-7).

SUMMARY OF FACTS

Distributing is a closely held S corporation (incorporated in Year 1) organized and with its principal place of business in State A. Distributing is owned (directly or through trusts) by seven individual family members, as follows: Shareholder A, which owns a% by vote and b% by value; Shareholder B, which owns c% by value; Shareholder C, which owns d% by vote and e% by value; Shareholder D, which also owns d% by vote

and e% by value; Shareholder E, which owns f% by value; Shareholder F, which also owns f% by value; and Shareholder G, which owns d% by vote and g% by value.

Distributing is engaged, directly or indirectly, in various businesses, including Business 1 and Business 2. Distributing owns an h% interest in LP 1 and an i% interest in LP 2.

Each of Business 1 and Business 2 is currently operated by LP 2 and managed by GP, an S corporation that is closely held by the same family that owns Distributing. GP is owned (directly or through trusts) by four individual family members: Shareholder A, which owns a% by vote and value; and Shareholders C, D, and G, each of which owns d% by vote and value. GP is the general partner of LP 1 and LP 2; it holds a j% interest in LP 1 and a k% interest in LP 2. An unrelated party owns the remaining l% interest in both LP 1 and LP 2.

Shareholders A, B, and C are involved in the management of Businesses 1 and 2. Each is also an employee of GP.

Financial information has been received indicating that each of Business 1 and Business 2 has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

PROPOSED TRANSACTION

For what are represented to be valid business purposes, Distributing proposes the following steps (the “Proposed Transaction”):

- (i) The Business 1 Employees will be transferred from LP 2 to LP 1 (the “Transfer”).
- (ii) Controlled will be incorporated in State A.
- (iii) Distributing will contribute all of its assets relating to the conduct of Business 2 – namely, its i% interest in LP 2 – to Controlled in exchange for all shares of stock in Controlled (the “Contribution”). Controlled will assume any and all liabilities of Distributing relating to the conduct of Business 2.
- (iv) Immediately after completion of the Transfer and the Contribution, Distributing will distribute all Controlled stock to the Distributing shareholders on a pro rata basis (the “Distribution”).
- (v) Controlled will make an election under § 1362(a) to be treated as an S corporation (within the meaning of § 1361(a)).

- (vi) Following the Distribution, Controlled will continue to be engaged in Business 2, and Distributing will continue to be engaged in Business 1 (among other businesses).

REPRESENTATIONS

The following representations have been made in connection with the Proposed Transaction:

- (a) Any indebtedness owed by Controlled to Distributing after the Distribution will not constitute stock or securities.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted concerning each of Business 1 and Business 2 represents its present operations and, with regard to each of Business 1 and Business 2, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees, except that: (i) certain employees of LP 2 and GP will continue to provide support with respect to Business 1; and (ii) Shareholders A, B, and C will continue to be involved in Business 2. All shared employees will be paid the fair market value of their services by these entities.
- (e) Neither Business 1 nor Business 2 nor control of an entity conducting either business will have been acquired during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part.
- (f) The Distribution is carried out for the following corporate business purposes: (i) separation of two distinct lines of business that are not necessarily compatible or mutually beneficial; (ii) isolation of Business 1 from the risks and liabilities of Business 2, and vice-versa; and (iii) provision of stakeholders in both businesses with the opportunity to focus attention on a single line of business. The distribution of the stock of Controlled is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (g) The Proposed Transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

- (h) The total adjusted bases of the assets to be transferred to Controlled by Distributing in the Proposed Transaction will equal or exceed the sum of the total liabilities assumed (within the meaning of § 357(d)) by Controlled.
- (i) The total fair market value of the assets transferred to Controlled in the Proposed Transaction will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of § 357(d)) by Controlled in the exchange, and (ii) the amount of any liabilities owed to Controlled by Distributing that are discharged or extinguished in connection with the exchange. The total fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (j) The liabilities to be assumed (within the meaning of § 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred to Controlled.
- (k) The aggregate fair market value of the assets transferred to Controlled in the Contribution will equal or exceed the aggregate adjusted basis of these assets.
- (l) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.
- (m) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution, other than intercompany loans or other obligations that have arisen in the ordinary course of business.
- (n) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.
- (o) For purposes of § 355(d), immediately after the Distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock or securities that were acquired by purchase (as defined in § 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the Distribution.

- (p) Payments made in connection with all continuing transactions between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (q) No two parties to the Proposed Transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (r) The Distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a fifty percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (s) Immediately after the transaction (as defined in § 355(g)(4)), neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).
- (t) Effective Year 2, Distributing made an election under § 1362(a) to be an S corporation (within the meaning of § 1361(a)), and Distributing has continued to be an S corporation since Year 2 (within the meaning of § 1361(a)).
- (u) Immediately after the Distribution, Controlled will be eligible to elect S corporation status pursuant to § 1362(a), effective immediately after the Distribution.
- (v) Controlled will elect to be treated as an S corporation effective immediately after the Distribution (see § 1.1361-3(a)(4)).
- (w) None of the persons holding stock, membership interests, or any equity interest in either Distributing or Controlled is a nonresident alien individual, a foreign corporation, or a trust (except for trusts meeting the requirements of § 1361(c)(2)).
- (x) There is no plan or intention to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.
- (y) Throughout the five-year period ending on the date of the Distribution, LP 1 and LP 2 were treated as partnerships for U.S. federal income tax purposes.
- (z) Neither LP 1 nor LP 2 will elect to be classified as an association taxable as a corporation under § 301.7701-3.

- (aa) Throughout the five-year period ending on the date of the Distribution, Distributing has owned a “significant interest” (within the meaning of Rev. Rul. 2007-42, 2007-28 I.R.B. 44) in each of LP 1 and LP 2.
- (bb) Distributing and Controlled will continue to own a “significant interest” (within the meaning of Rev. Rul. 2007-42, 2007-28 I.R.B. 44) in LP 1 and LP 2, respectively, immediately after the Distribution.
- (cc) Each of Shareholder A, Shareholder B, and Shareholder C was a shareholder of Distributing throughout the five-year period ending on the date of the Distribution.
- (dd) Each of Shareholder A, Shareholder B, and Shareholder C will continue to be a shareholder of Distributing and will be a shareholder of Controlled immediately after the Distribution.
- (ee) Each of the Business 1 Employees will be transferred from LP 2 to LP 1 before the Contribution.

RULINGS

Based solely on the information submitted and the representations set forth above, this office rules as follows:

1. The transfer by Distributing to Controlled of part of its assets in exchange for all Controlled stock followed by the distribution of all Controlled stock to the Distributing shareholders will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled each will be “a party to a reorganization” within the meaning of § 368(b).
2. No gain or loss will be recognized by Distributing upon the transfer of assets to Controlled in exchange for Controlled stock and the assumption of liabilities. Sections 361(a) and 357(a).
3. No gain or loss will be recognized by Controlled on the receipt of assets in exchange for Controlled stock. Section 1032(a).
4. Controlled's basis for each asset received from Distributing will equal the basis of that asset in the hands of Distributing immediately prior to the Proposed Transaction. Section 362(b).
5. Controlled's holding period for each of its assets received from Distributing will include the period during which Distributing held the asset. Section 1223(2).

6. No gain or loss will be recognized by Distributing on the Distribution. Section 361(c).
7. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) the Distributing shareholders upon their receipt of Controlled stock. Section 355(a).
8. The aggregate basis of the Controlled stock and the Distributing stock in the hands of the Distributing shareholders will equal the basis of the Distributing stock held by such shareholders immediately prior to the Distribution, allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of the Distributing and Controlled stock after the Distribution. Section 358(a)(1), 358(b)(2).
9. The holding period of the Controlled stock received by each Distributing shareholder will, in each instance, include the holding period of the Distributing stock with respect to which the Distribution is made, provided that such Distributing stock is held as a capital asset on the Distribution date. Section 1223(1).
10. Proper allocations of Distributing's earnings and profits will be made, in accordance with the provisions of Sections 312(h) and 1.312-10(a), between Distributing and Controlled.

CAVEATS

No opinion is expressed or implied about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, this office has not reviewed any information pertaining to, and has made no determination regarding: (i) whether the Proposed Transaction satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the Proposed Transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see §§ 355(a)(1)(B) and 1.355-2(d)); or (iii) whether the Proposed Transaction is part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). In addition, no opinion is expressed regarding issues relating to Distributing's status as an S corporation or Controlled's subchapter S election.

PROCEDURAL MATTERS

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Lisa A. Fuller
Senior Counsel, Branch 1
Office of Associate Chief Counsel (Corporate)